

## AMD's Spin-off: Abu Dhabi to the Rescue

### The chipmaker's manufacturing operations will become a new company majority-owned by the Gulf nation, taking the cost of maintaining factories off AMD's hands

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Chipmaker Advanced Micro Devices took the wraps off a long-awaited reorganization on Oct. 8, announcing a plan to spin off its manufacturing operations into a separate company that it will jointly own with investors from Abu Dhabi.

The new company, Foundry Co., will be comprised of AMD's (AMD) factories in Dresden, Germany, and one yet to be built in Saratoga, N.Y. Essentially a for-hire factory, Foundry will make AMD chips under contract but also have the freedom to win business from other chip companies. Foundry joins the ranks of such chip foundry companies as Taiwan Semiconductor Manufacturing (TSM); United Microelectronics (UMC), also of Taiwan; Chartered Semiconductor (CHRT) in Singapore; and IBM Microelectronics, a unit of computing giant IBM (IBM).

The spin-off helps AMD reduce the high chip-manufacturing costs that, along with a poorly executed acquisition of ATI Technologies, have fueled losses and led to the July removal of CEO Hector Ruiz, who was replaced by Dirk Meyer. Shorn of its factories, AMD can refocus its efforts on designing PC microprocessors and graphics chips for customers such as Dell (DELL) and Hewlett-Packard (HPQ). Ruiz stayed on as chairman, with oversight of the reorganization (BusinessWeek.com, 08/11/08), code-named Asset Smart, that has been in the works for years. "This is the best of all possible outcomes for AMD," says Ashok Kumar, an analyst at Collin Stewart in San Francisco. "AMD will still have a lot of control over its manufacturing. There's no reason now they can't return to sustainable profitability."

#### Minority Owner, Equal on the Board

AMD will spin off its fabricating factories, or fabs, as they're commonly known in the industry, to the new company. Most of its operating capital will come from Advanced Technology Investment Company, an investment firm wholly owned by the government of Abu Dhabi, an oil-rich Arab state in the Persian Gulf. ATIC will invest \$2.1 billion in Foundry—\$700 million of which will be paid directly to AMD—for a 55.6% equity stake. AMD will be a minority owner, owning 44.4%. Both AMD and ATIC will be equally represented on the board of directors. Foundry will assume about \$1.2 billion, or about 24%, of AMD's long-term debt. Doug Grose, AMD's senior vice-president in charge of manufacturing and a former IBM exec, will be Foundry's CEO. ATIC has pledged to provide additional equity funding of \$3.6 billion to \$6 billion over the next five years.

Abu Dhabi's investment arm, Mubadala Development, paid \$622 million for an 8% equity stake in AMD in November, when the company was trading at \$12.70. Since then, AMD's stock has lost 64% of its value, even after an Oct. 7 rally that left the stock 8.5% higher, at \$4.59. With this new transaction, Mubadala has boosted its stake in AMD to 19.4%, paying \$314 million for 58 million shares, plus warrants for an additional 30 million shares.

#### Pricey Upkeep

AMD has racked up losses of \$1.6 billion on sales of \$2.8 billion this year, and much of those losses are associated with the expense of owning and operating expensive chip fabs that cost about \$3 billion to \$5 billion apiece to build, and about \$1 billion to upgrade every two years or so. There are also costs related to holding and distributing stockpiles of unsold chips (BusinessWeek.com, 05/30/07) when demand doesn't match expectations.

AMD's research-and-development expenses—\$1.85 billion, or 30% of sales, in fiscal 2007—will drop significantly, says Doug Freedman, an analyst at American Technology Research in San Francisco. "We estimate that AMD spends \$150 million to \$200 million per year on process-technology R&D," he wrote in an Oct. 7 research note. Freedman rates the stock a "buy" with a price target of \$10.

Although AMD stands to gain from lower operating expenses, it will be transferring much of its intellectual property—and some that it doesn't own—to a third party. That may not sit well with Intel (INTC), with which AMD has had a series of cross-licensing agreements going back to the 1970s. The latest such agreement expires in 2010. Intel spokesman Chuck Mulloy says the company "has some concerns" about the deal but declined to be specific. "The agreement gives them a number of rights with respect to our technology and gives us some rights with respect to their technology," he says. "We're in the process of evaluating this, and we have a lot of questions. As is our normal practice, we will vigorously defend our intellectual property." The companies are already litigating an antitrust suit filed by AMD against Intel in 2005.

## Drop in Global Demand

While AMD has arrangements with Singapore's Chartered Semiconductor to pick up extra chipmaking work when demand outstrips its capacity, slack demand costs big money in underused equipment. Foundry will be free to seek business from other chip companies that don't own their own fabs. "The good news for AMD is that they won't have to worry about absorbing the expense of all that capacity with just their own production requirements," says Nathan Brookwood, head of research firm Insight64.

AMD's headcount will drop by about 3,000 as its manufacturing employees are shifted to the new company. But these same employees will still be devoted to making AMD's chips. New employees will be added in time as Foundry attracts new customers, Sonderman says.

The breakup would seem much better news if worldwide demand for PCs and other products that require chips looked stronger. "We recently met with several major PC makers in Taiwan who suggested that...fourth-quarter orders have been cut in recent weeks due to global macro demand deterioration," Craig Berger, an analyst at FBR Research, wrote in a recent note.